THE NATIONAL CITY BANK OF NEW YORK

1947

Monthly Letter on Economic Conditions Government Finance

New York, June, 1947

General Business Conditions

THE business news during May has provided little confirmation for the views of either the optimists or the pessimists, unless the latter have found comfort in declining stock prices and disappointing home building figures. Commodity prices are lower on the whole, but showed signs of stiffening toward the end of the month, and the bulk of the evidence is against further precipitate or disorderly decline, now that the disorderly advance of February and early March has been retraced. In industry, the flattening out of the rise, which marked the situation during April, is again reflected in the May figures.

The opinion that the peak of the postwar boom has been seen is now fairly general. Where recession has occurred, however, it is still of little weight, so far as the aggregates of production, income or employment are concerned. The volume of industrial output has dropped a little during April and May, but of even this small decline only a part reflects a catching up with demand. Much of it is accounted for by the coal shutdown in April, the effect of coal shortage and other difficulties on steel production, and the effect of steel shortage on automobile output. In neither steel nor automobiles is there any lack of orders on the books, and producers of both would be increasing their output if they could.

In some luxury goods, in shoes, soft woolens, to a small extent in cottons, and even in a few metal products, curtailment has appeared which reflects supply overtaking demand, but it is not in sufficient degree to make much impression on the general situation. Retail trade has been somewhat better than in the early Spring, which suggests that the unseasonable weather earlier may have had more to do with the pre-Easter sluggishness than was realized at the time. Markdown sales have become more common; at the same time, the response to lower prices or better quality of merchandise is encouraging.

The Significant Changes

In the main, therefore, the evidence of recession thus far does not take the form of a lessened flow of goods and services or any material decline in employment — where recession would hurt most — but rather of changing conditions of doing business. The most significant changes that have occurred are in the price trend of basic commodities, the filling up of shortages of more and more consumers' goods, and buyers' resistance to out-of-line prices, including construction. If the general view that the peak of demand and prices has been passed is correct, profits will no longer come as easily. The going will be harder for new or rapidly-expanded concerns than it was during the war and postwar boom. It will be harder for everyone who cannot meet competitive costs.

As pointed out in another article in this Letter, more than two million new enterprises have been

CONTENTS

started since 1940. It is a reasonable presumption that they include a fair share of people who are inexperienced or incompetent or who are seeking a place in markets which are not big enough for all who are trying to enter them. Competitive forces will determine the survivors, and in the process failures and losses are naturally to be expected. Well established and efficient concerns also have the problems of fitting their products to consumers' wants and ability to pay, and of selling instead of merely taking orders. Wasteful practices need to be searched out and eliminated. Where costs and prices are notably out of line, as in building, all elements in the industry have the problem of getting them down — generally in the face of rigid wage costs.

However well or poorly these adjustments are carried out, the situation holds strong supporting influences. Markets for farm products, and also for many industrial goods, will have the support of heavy export demand for a considerable time to come. Many of the country's major industries, including automobiles, petroleum products and various equipment machinery producers, will be maintaining employment and incomes while the soft goods industries are making their corrections. It is in the outlook for durable goods, for exports, and, not least, for tax reduction, that the best reasons for believing that forthcoming readjustments will be cushioned are to be found.

The test of the situation in the coming months will not be the difficulties of individuals or even the course of prices, but the state of employment and the output of goods and services to promote the general welfare. One of the hopeful elements is that the prices which are highest relative to other prices, namely farm products, are also the prices which can come down with least effect on production and employment. However, farmers who see their prices decline while they maintain production will be entitled to feel resentment if efforts to sustain other prices, such for example as the price of building labor, result in curtailment of production. The policy of all groups, during this period when the supporting influences are strong, should be to get efficiency up and costs down, against the time when exports, inventory accumulation and deferred capital goods requirements fall off.

The Export Boom

Recorded exports for March reached the unprecedented peacetime figure of $1.3 billion. This is at an annual rate close to $16 billion. Including services, and relief and other shipments to occupied areas, we were in March supplying foreign countries with goods and services at an annual rate of about $20 billion. This is more than we sent abroad at the height of the war, when Lend-Lease accounted for about four-fifths of our total shipments.

With 10 to 15 per cent of the goods produced in this country going abroad, exports play a role of great importance in business. They are contributing to full employment and to the maintenance of the purchasing power of the farm areas. In a few lines which no longer find ready domestic buyers for all they can produce, exports help absorb output and sustain prices. As the domestic situation changes, they grow in importance as a stabilizing influence.

The "Favorable" Balance

It may be gratifying to know that we are accumulating a record "favorable" balance of trade. More important is the disconcerting possibility that our mounting exports may reflect a set-back in world recovery rather than progress in rehabilitation. At the beginning of the third year of peace, we are still unchallenged as the most important source of goods — not only of specialized industrial and transportation equipment, but of such products as semi-finished steel, coal and many types of consumers' goods. Latin America and Asia are still looking to us rather than to Europe for industrial goods. More food may be required to tide Western Europe over the next crop season than during the months just passed.

Our imports are also being affected by the slowness of world recovery. Our March imports from Europe were below the 1946 as well as the 1939 monthly average, and there is little hope that Europe can export much more in the early future. Meanwhile we are also buying fewer raw materials, which have assumed a greater importance in our import trade because of the high level of our industrial production. Our purchases of wool, silk, furs, textiles, liquors, leather goods, diamonds and ferro-alloys are below last year, and there is a marked tendency to get on a hand-to-mouth basis on other things as protection against price declines. As a result, the annual rate of imports during the first quarter of 1947 was only about $5.6 billion. The Department of Commerce anticipated that 1947 imports would reach about $6.7 billion. If imports were in the same relationship to our national income as in the past, they would be running at an annual rate of about $8.5 billion.

Drain on Dollar Resources

The expansion of our exports and the failure of our imports to follow suit seems likely to

upset the Department of Commerce calculation of our 1947 international payments which we discussed in our April issue. Only a few months ago it seemed that the excess of our exports of goods and services would be around $7 billion. All but about $1.5 billion were to be covered by drawing on outstanding dollar credits and by gifts. Instead, the excess of exports of goods and services during the first quarter was at the annual rate of about $12 billion. This means that foreign countries are incurring a deficit of $1 billion a month in their international transactions with the United States. According to the estimates of the Department of Commerce, to pay for the deficit over and above the dollar credits available, they drew on gold and dollar balances at a rate close to $5 billions a year.

Since this draft is more rapid than had been contemplated, the outlook for maintaining exports at the present level to that extent is deteriorating. Many signs point to the intensification of this drain: the weakening of the gold and dollar position of Canada and Sweden; the downward trend of reserves in practicaly all the Latin American countries; the drawings on dollar credits by Great Britain and Western Europe and the restrictions enforced on purchases from this country.

The tightness, however, may be somewhat relieved by increasing gifts and dollar loans. Since the beginning of the year the appropriation for Greece and Turkey, the loan by the International Bank to France, Export-Import Bank credits, some private loans, and the credits extended by the International Monetary Fund have added at least one billion dollars to the dollar resources available to foreign countries. More will probably be granted in the near future, by the International Bank certainly.

Distribution of Exports

Significant of the situation is that last March only 16 countries out of 137 listed by the Department of Commerce sent us more goods than we shipped to them: they include Malaya, Cuba, El Salvador, Colombia, Curacao and certain colonial areas in Africa. Our exports to some important countries, such as Mexico, Brazil, Argentina, French North Africa and others were ten times as high as the 1939 monthly average.

The table below shows the distribution of American exports by major geographic groups during the first quarter (projected to a 12 month basis) with comparisons for 1946 and 1936-38. The table also gives the export balances. The most significant item is the huge trade deficit of Western Europe and the shift in Latin America's position. In 1945 we still had an import balance of nearly $360 million in our trade with Latin America; last year we had an export surplus of $340 million. In the first quarter this surplus was at an annual rate of $1,600 million, a rate which obviously cannot be held.

Distribution of U. S. Exports and Export Balances
(In Millions of Dollars)

	Exports			Export Balances		
	1936-38 Aver.	1946 Total	1947 Rate*	1936-38 Aver.	1946 Total	1947 Rate*
Canada	454	1,442	1,893	+109	+ 559	+ 920
Latin America	485	2,100	3,725	— 58	+ 340	+1,608
U. K.	499	855	1,330	+325	+ 699	+1,141
U.S.S.R.	49	358	191	+ 24	+ 257	+ 147
Continental Europe:						
Western	609	2,246	3,364	+195	+1,775	+2,951
Other	69	607	532	— 28	+ 542	+ 437
Africa, Near East	160	619	964	+ 63	+ 129	+ 548
Far East	557	1,328	1,980	—200	+ 422	+ 710
All other	85	187	395	+ 43	+ 82	+ 265
Total	2,967	9,742	14,374	+478	+4,807	+8,727

*First quarter figures multiplied by four.

In summary, both our export total and the deficit balance which foreign buyers have to finance have exceeded earlier predictions. Further credits have been extended, but the drain on foreign dollar resources is at a rate which can hardly be maintained. Indications still point to larger exports and a larger trade balance for 1947 than for 1946. But it is too much to expect that exports can continue at the extraordinary March levels unless imports increase substantially.

Federal Finances and the Money Market

With the scheduled cash redemption of $1 billion of the certificates of indebtedness which mature on June 1, the Federal Government will bring its retirement of public marketable debt since the turn of the year up to a total of $7½ billion. This is more debt retirement than had been anticipated six months ago for all of 1947. The June certificate redemption should bring the total federal debt down to $257 billion, $3 billion below the figure foreseen for June 30, 1948 in the President's budget last January.

While this $7½ billion of debt retirement falls short of the $23 billion redeemed in the last ten months of 1946, it has a radically different meaning for the economy as a whole. The debt redemptions in 1946 were accomplished almost entirely by drawing down idle government deposits held in War Loan account with the banks; the actual intake of tax and other revenues last year exceeded the cash outgo by no more than one billion dollars.

In contrast, debt this year is being paid off primarily from a cash surplus, which means with money withdrawn from the spending stream, through taxation of multifarious forms, sales of

surplus property, and other receipts. Some of the debt retired is held by the general public and redemptions put the money back where it can be spent or reinvested. But the greater part of the securities paid off are held by the Federal Reserve and commercial banks and the result is a reduction in the money available for spending or investing in the hands of the people.

The Drain on Spending Power

The government's net drain on spending power has been a good deal heavier than is indicated by the amount of the budget surplus. This comes about, first, because cash income is regularly much greater than "net receipts" under the budget, and, secondly, because actual cash outgo is frequently less than total budget expenditures. The tax collected for accumulating the old age pension fund is an example of a tax which is not counted in "net budget receipts" but which still drains spending power out of the economy. The issuance to veterans of deferred leave bonds, due some years hence, provides an example of "budget expenditures" which do not represent immediate cash outlays.

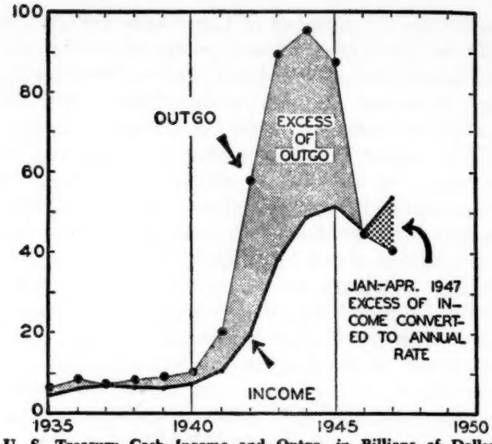
In the first four months of 1947, the government cash income exceeded its cash outgo by $4.4 billion, equivalent to an annual rate of $13 billion. As the following table brings out, the surplus on a budget basis came to no more than $1.8 billion over these same four months, which works out to an annual rate of around $5 billion.

Government Actual Cash Income and Outgo Compared with Net Budget Receipts and Expenditures, January-April, 1947
(In Billions of Dollars)

	Budget Basis	Cash Basis
Income	16.4	17.9
Outgo	14.6	13.5
Surplus	1.8	4.4
Annual rate of surplus, approximately	5	13

What a radical change this represents from the wartime period, when in each of four consecutive years the Government poured out $35 to $50 billion more than it took in, is suggested in the accompanying chart. In fact, it would be necessary to go back more than fifteen years, to a period not covered in the chart, to find a time when taxes were pulling more money out than government expenditures were putting back in.

This counter-inflationary force, on the scale that has been experienced, had been neither expected nor planned for. It has developed, not out of expenditure cuts, which are being laid out for next year, but out of a tax system which raises tax yields automatically and disproportionately when the level of the national income rises. The buoyancy of the national income, fed by private spending and investing, has confounded theorists who predicted vast unemployment as government spending came down from its colos-



U. S. Treasury Cash Income and Outgo, in Billions of Dollars (Calendar years).
Source: Treasury Bulletin except that April, 1947 is computed from Treasury Daily Statements.

sal peaks. It has required one upward revision after another in official revenue estimates for the fiscal year ending June 30 – from an original figure of $31½ billion forecast in January, 1946 to the latest estimate of $42½ billion given out April 19, 1947.

On the other hand, there should be no reason for surprise that, coincidentally with the development of this billion-a-month cash surplus, we should be reading official reports of a leveling off in business volumes, overall, and more especially in business investment. In this latter field taxes act as a deterrent even apart from the algebraic balance between cash income and outgo.

In other words, there is a question of how much of a tax-drag a free economy in peacetime can stand. No one can predict with any confidence just how much that is, but the biggest present risk is that of undermining the vigor of the economy by overtaxation.

Easing Influences in Money Market

The banks, following last year's loss of most of their government deposits and the associated reduction in short-term government security holdings, this year have experienced a contraction in private deposits as an incident to the government surplus. The decline in deposits would have been more pronounced except for gold and currency receipts and for the substantial amounts placed to the credit of business borrowers in the early months of the year. In some areas banks have also been active in extending real estate mortgage credits and personal loans, though at the same time collateral loans have fallen off to new low levels. In recent weeks business borrowings have dropped back to the end of February level, partly reflecting repayments of commodity credits.

Sales of gold by foreign central banks and Governments, to help finance their imports, have been around $1 billion since the turn of the year, and the return of currency from circulation since Christmas runs to about the same magnitude. These factors, since they add to bank reserves, tended to ease the money market, but were substantially offset by the public debt retirement and official counter-moves.

In January and February the Treasury drained off bank reserves by letting its own deposit balances with the Federal Reserve Banks move up from a normal one-half billion to well above $2 billion. In March and April, easing tendencies were countered by a $1½ billion reduction in certificate holdings of the Federal Open Market Account and by a resumption of selling of government bonds by Treasury investment accounts.

Beginning at mid-April and continuing through May 22 the Treasury redeemed a total of $1 billion Treasury bills. Since these securities are predominantly held by the Federal Reserve Banks, their retirement led to a drain on bank reserves. By mid-May the banks were back in a position where they were having to sell certificates in order to replenish their reserve balances.

Retirement of Treasury Bills

The retirement of Treasury bills came during a two months' gap in certificate maturities, when they represented the only outlet available for debt retirement. Nevertheless, some observers were inclined to the view that the action, the first significant reduction in the outstanding amount of bills in five years, might presage other steps leading up to an "unfreezing" of interest rates on short-term government securities.

As Chairman Eccles of the Federal Reserve Board indicated in testimony before the House Banking and Currency Committee in early March, the ⅜ per cent rate on Treasury bills, set by the Federal Reserve Open Market Committee five years ago, is out of tune with the market. As a result, the Federal Reserve Banks, buying freely at this rate, have accumulated about 90 per cent of the entire amount outstanding. Mr. Eccles, at the same time, suggested that it might be desirable to allow short-term rates to rise to keep the long-term rates from falling further.

That the authorities had in mind, when they considered the time propitious, at least letting the Treasury bill rate find its own level, seemed to be confirmed by two other actions taken during the latter part of April. The Federal Reserve Board levied interest charges, payable to the U. S. Treasury, on Federal Reserve note issues not covered by gold certificates. This action, which in effect reimposes a franchise tax on Federal Reserve Bank earnings, would return to the Treasury the bulk of any increase in interest earnings of the Reserve Banks resulting from the restoration of some flexibility of rates on short-term government securities.

The second action, taken by the Treasury, was to permit holders of maturing Treasury bills to use them in payment for the new weekly offerings. This procedure enables the Federal Reserve Banks, the principal holders, to replace their maturities directly instead of relying on dealers and banks to bid for excessive amounts for immediate resale to the Reserve Banks at the fixed ⅜ per cent rate. In effect, the ⅜ per cent rate, at which the Federal Reserve Banks stand ready to buy bills, is now narrowed in scope to the billion or billion and a half "remnant" of bills not already in the Federal Reserve portfolio.

Government bond prices, meanwhile, have displayed remarkable stability in the face of many rumors of impending policy changes. Their performance, and the ready absorption of top grade corporate, state, and municipal bonds bear witness to the abundant supply of funds for investments where the market evaluates the risk of non-payment as small or negligible. It also reflects the bottlenecks and high costs in construction, which are holding up the supply of real estate mortgages, and the pressure on banks to shift to longer term governments in order to improve investment returns and meet higher costs of operation.

At the same time, the supply of genuine risk capital, as clearly evidenced by the depression of stock prices and new stock offerings, presents a radically different picture. Compared with the 2.3 per cent available to investors by the purchase of long-term government bonds. Moody's Investors Service calculates that the average yield on 200 common stocks has now risen to 5.1 per cent, highest in three and a half years.

Where Profits Went

In a study released last month by the Securities and Exchange Commission it was estimated that the net working capital of all corporations in the United States, except banks and insurance companies, increased during last year by almost $5 billion and reached a new high over $57 billion on December 31. This comprehensive survey is timely not only as showing the changes in working capital, but as shedding light on what happened to the large aggregate of 1946 corporate earnings. These have been estimated by the Department of Commerce at $12 billion, with about $5 billion paid out in dividends and

$7 billion retained in the business. In some quarters the earnings have been cited as sufficient to permit a general increase in wages and at the same time a substantial decrease in selling prices. The S. E. C. figures, summarized below for 1945-46, help to answer the question where these earnings are, or where they went.

Current Assets and Liabilities of All U. S. Corporations, Excluding Banks and Insurance Companies, as Estimated by the Securities and Exchange Commission
(In Billions of Dollars)

	December 31, 1945	December 31, 1946	Change
Current Assets			
Cash on hand and in banks	$22.2	$21.8	— .4
U. S. Govt. securities	21.2	15.0	—6.2
Receivables from U. S. Govt.	2.7	.7	—2.0
Other notes and accts. rec.	22.3	29.9	+7.6
Inventories	26.7	35.3	+8.6
Other current assets	2.4	1.7	— .7
Total current assets	97.5	104.5	+7.0
Current Liabilities			
U. S. Govt. advances and prepayments	0.9	0.1	— .8
Other notes and accounts payable	24.9	30.8	+5.9
Federal income tax liabilities	11.2	8.5	—2.7
Other current liabilities	7.9	7.9	—
Total current liabilities	44.9	47.2	+2.3
Net Working Capital	52.6	57.3	+4.7
Ratio: Current Assets to Current Liab.	2.17	2.21	

It will be seen that last year over $8 billion was put into inventories. The increase reflects in part the heavy and rising volume of business; in part the advance in commodity prices; and in part lack of inventory balance due to shortages of necessary parts or materials. At the same time, accounts and notes receivable (exclusive of receivables due from the Government on war contracts whose liquidation was practically completed last year) absorbed over $7 billion as a result of the high volume of civilian sales and the resumption of normal credit granting. Cash was maintained close to the level of a year earlier, but holdings of government securities were reduced by over $6 billion.

Business Forced to Borrow

On the liability side, the reduction in federal income taxes payable and in government advances and prepayments was more than offset by an increase of nearly $6 billion in notes and accounts payable, so that total current debt was up over $2 billion.

Although total current assets of $104 billion against total current liabilities of $47 billion left a margin of $57 billion in net working capital, the report points out that, due to the change in character of the current assets,

> Working capital at the end of December was not in as liquid a form as in the preceding year . . . The ratio of corporate liquid funds in the form of cash and U. S. Government securities to sales, which is one rough measure of liquidity, declined during 1946 but is still above prewar levels.

In addition to the absorption of funds by inventories and receivables last year, there was a net investment of $5 billion in property account. This represents outlays for reconversion, modernization, and additions to plant and equipment, and is exclusive of expenditures for plant maintenance and repairs. In many cases the normal maintenance, deferred during the war period because of lack of materials and man-power, has not yet been fully made up and requires further expenditures this year. Moreover, because of sharply higher wages and prices, present replacements costs are much higher than the original costs upon which depreciation reserves are usually based.

Not only were all of the retained net earnings after dividends invested in fixed and working assets, rather than accumulated in the form of cash, but $700 million additional net capital was raised by issuing long-term bonds, and $2.5 billion about evenly divided between long-term bank loans and new stock. Thus, while people are still talking about the "record" profits and retained earnings in 1946, corporations have had to borrow heavily and sell additional stock in order to meet the capital requirements of the business.

People not versed in accounting often fail to understand the distinction between "surplus" and "cash", and think that the retention of earnings implies an accumulation of idle cash available for payment of increased wages or dividends, or for reducing prices, whereas usually such earnings carried to surplus are not in the form of cash but have already been absorbed.

Example of Department Stores

A concrete example showing both where earnings came from and when they went is supplied by department stores reporting for the fiscal year ending on or around January 31, 1947. The following is a composite statement of the country's ten largest department store organizations:

Ten Large Department Store Organizations Having Sales Over $100 Million for Fiscal Year Ended January 31, 1947*
(In Millions of Dollars)

Income Account	1946	1947	% Change
Net sales and other income	$1,676	$2,218	+ 32
Cost of goods, oper. exp., reserv., etc	1,507	2,028	+ 35
Net income before taxes	169	190	+ 12
Federal income & excess profits taxes	120	80	— 33
Net income	50	110	+120
Preferred & common dividends paid	23	38	+ 65
Retained in business	26	71	+173
Net profit margin on sales	3.0%	5.0%	
Current Assets and Liabilities, January 31			
Cash	97	81	— 16
U. S. Government securities	186	55	— 71
Inventories	193	303	+ 57
Receivables	121	212	+ 76
Total current assets	596	651	+ 9
Total current liabilities	164	227	+ 38

* Allied Stores Corp., Associated Dry Goods Corp., Bullock's, City Stores Co., Federated Department Stores, Marshall Field & Co. (year ended Dec. 31), Gimbel Brothers, R. H. Macy & Co., May Department Stores Co., and Mercantile Stores Co.

It will be noted, first, that sales increased 32 per cent and net income before taxes increased by only 12 per cent in the year. Income tax liabilities were 33 per cent lower, due to elimination of the wartime excess profits tax, and mostly accounted for the rise of 120 per cent in net income remaining after taxes.

If this final figure is really "net", it is significant that the directors of these companies saw fit to pay out only about one-third of it in dividends. And for every $1 of retained income, inventories and receivables together went up almost $3, in addition to which there were substantial expenditures for improvements to store properties. Holdings of cash were reduced despite heavy liquidation of government securities, and there was a large increase in current debt.

"Swallowing Up" Small Business

Among subjects of perennial agitation and conroversy is the question of the growth of monopoly resulting from the "swallowing up" of small business by "giant corporations" through purchase or merger in one form or another. Recently the Federal Trade Commission, in a special report to Congress entitled "The Present Trend of Corporate Mergers and Acquisitions" called attention to the purchase of more than 1800 manufacturing and mining companies by a much smaller number of concerns since 1940. It has renewed its drive for passage of legislation – pending for some time in Congress – that would enlarge its authority under the anti-trust laws to prohibit corporations from purchasing assets of other corporations where the effect is deemed to contribute to monopoly. The Commission under the present law has power only to prevent acquisitions through purchase of capital stock, which authority of and by itself is declared to be "practically meaningless."

In a public address last month, Commissioner Robert E. Freer was quoted as blaming the present high price level on the influence of increased corporate mergers and concentration of many products in comparatively few hands.

It is altogether proper that the Federal Trade Commission should be concerned with the future of small business enterprises and the preservation of conditions of free competition. That, after all, is part of the job it was set up to do. Everyone recognizes the importance to the country of a vigorous and enterprising small business population. One of the strong elements of our democracy has been the large number of small, owner-operated concerns and the spirit of freedom and independence which this encourages. Any investigation that throws real light on influences that may be retarding small business is to be welcomed.

The Concern with Monopoly

Unfortunately, the Commission in its special report does not appear to have taken a very well-rounded view of the problem. The report says a great deal about the reasons why big concerns might want to acquire little ones, but nothing about the reasons why little concerns might want to sell out to big ones. Moreover, in referring to the larger concerns doing the purchasing, there is a constant harping on the monopoly motive. The preoccupation of the report with that theme is illustrated by the following excerpts:

> During wartime, there is little incentive for large corporations to acquire small businesses. New facilities which are needed to produce war products are generally supplied by the Government. However, as victory looms in sight, and the elements of competition and control over markets again become important, there occurs a revival of interests in mergers and acquisitions . . .
>
> Many horizontal acquisitions have been instigated by the desire of large concerns to eliminate troublesome competitors producing a similar line of goods . . .
>
> In short, the figures indicate, conclusively, that the major impetus behind the current merger movement has been the desire of giant corporations to consolidate their wartime gains and to expand the scope of their domination through acquisition of smaller, independent enterprise.

No doubt what the Commission says is true to a degree, but it is far from telling the whole story. Reserving for a moment the question as to why small concerns sell out, it is pertinent to point out that large corporations may find it advantageous to acquire other concerns for many reasons having nothing to do with desire for monopoly. Desire to assure more adequate and dependable supplies or wider sales outlets is a sound business motive not involving any question of domination or undue supression of competition. The same may be said of the desire to round out lines by adding products that can be processed and distributed to regular customers at little additional cost, or of the desire for diversification so as to iron out seasonal and cyclical peaks and valleys and thus afford more stability of employment and earnings.

Still another motive, prominent at the present time, is the desire to purchase plants that have not been particularly successful but where opportunity is seen for effecting economies through improved management and technology and the investment of new capital, thus offsetting the general rise that has occurred in wage rates and raw material costs.

Consolidations based on such considerations, and carried out wisely and within reason, con-

tribute to business efficiency and are in the general public interest.

Why Small Businesses Sell Out

The most serious shortcoming of the Federal Trade Commission report, however, is its failure to deal adequately with the reasons why small firms sell out. The fact is that there are good and sufficient reasons for such selling, quite apart from any pressure from "giant monopolies."

The most important of these inducements is strangling taxation. Most small businesses, whether incorporated or unincorporated, are owned by a few individuals. If incorporated, the business pays a combined normal tax and surtax of 38 per cent (plus 2 per cent for consolidated returns, but with a preferential graduated rate of 21 to 38 per cent on taxable net incomes up to $50,000). It is required by law, subject to penalty taxes, to distribute 70 per cent of net income as dividends unless it can demonstrate the need for greater retention of earnings in the business. The dividends are then subject to the high individual surtaxes. On a straight arithmetic basis the owners of the business find themselves better off to sell out, pay the capital gains tax on any increment in value, and put the money in diversified investments and trust funds, than they are to continue in business with the usual risks and responsibilities.

In the case of unincorporated business, the tax-incentive for selling out is still more compelling. For here the major share of the earnings is immediately drained off by being subject to individual surtaxes. Such enterprises find that the more efficient they become and the more they get costs down, the more than have to pay in taxes instead of having the money to put back into a growing business.

Then there are the estate taxes, which pose special problems and perils for small business. With a proprietorship or partnership, death of one of the principals may mean taking out a large sum of money to pay taxes, thereby wrecking the business. With a corporation it may mean forced liquidation of a substantial block of stock, and in the case of small corporations there is often little or no market for such stock. For these reasons, owners of small businesses who are getting along in years frequently find a strong inducement to sell out their holdings, either for cash or readily marketable securities. As for the point that they sell to other companies and promote monopoly, the obvious fact is that there is very seldom opportunity to sell a small or medium-sized concern except to another concern in the same or a related line.

In other words, through the operation of the tax laws, we find a situation where at the same time that one branch of the Federal Government is condemning corporate purchases and mergers as contributing to monopolies, another branch is speeding the process by encouraging owners of small businesses to sell.

Other Handicaps

Taxation, of course, is not the only handicap from which small businesses particularly suffer. The growing multiplicity of labor laws and restrictions, strikes, numerous and voluminous reports to manifold government agencies, collections of income taxes, social security taxes, sales and excise taxes, and in many cases even of labor union dues, all impose special burdens upon concerns of limited manpower and financial resources. Moreover, such obstacles are in addition to the traditional disadvantages to which many small businesses have always been subject and which arise largely from the very ease with which people can establish many thousands of new enterprises each year, with practically no restrictions as to ability, experience, or capital.

The point to be made, however, is that none of these difficulties and disabilities is going to be removed by the kind of action the Federal Trade Commission proposes. As the Wall Street Journal aptly observes in an editorial of May 13 –

> The competitive position of the small enterpriser, his chance for survival, cannot be improved by giving a government agency power over him and his competitors. Real relief for him, if it depends on governmental action, lies in the opposite direction of less control, less interference with his freedom of action, lighter tax demands upon his resources.
>
> As for the problem of occasional or threatened monopoly, it will have to be approached by a different route and without injuring the small enterpriser by restricting his freedom to sell out. If his position becomes impossible, his extinction will reduce competition in the field. No grant of power to the Commission can do anything about that.

Finally, the Commission's report neglected to mention the large number of new firms entering business since 1940. While the Commission has been worrying about 1800 mergers, 2,126,000 new establishments have been started. Though the total business population fell off sharply during the war, a rapid comeback since V-J day carried the total by last September to an all-time high of 3,599,000, according to the Department of Commerce. This will go far toward restoring the prewar proportions of small to big business. Apparently, despite all handicaps, the spirit of enterprise and the desire for independent proprietorship remain strong.

The Building Cost Problem

The failure of home building to improve substantially this Spring has disappointed earlier hopes that a million new permanent house and apartment dwelling units might be completed this year. High costs have caused deferment of building plans, particularly for large-scale sale projects, because it has become plain that buyers cannot or will not pay the prices asked. In building for rental, high costs are one discouragement, rent controls another. The tendency to hold off has developed despite improvement in materials supplies. House construction time in some areas has been reduced to four to five months from the seven to nine months required last year. This is getting back toward the prewar average of three to four months. Unfortunately the beneficial effects on costs have been largely offset by continued low output of building workers, by further advances in wages in one area after another, and until recently by rising materials prices.

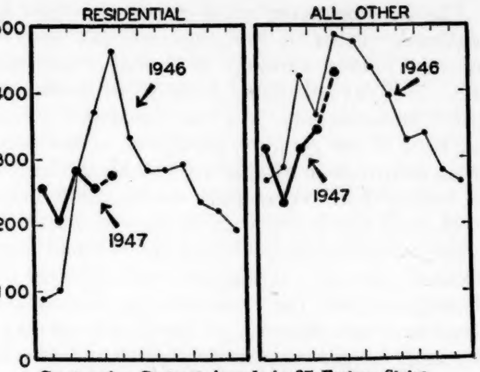
Government economists now are looking for completion of about 750,000 dwelling units this year. The revised estimate still exceeds by two-thirds the number of units completed last year. It is a fifth under the 937,000 built in the peak year 1925. At the beginning of this year 336,000 family units were under construction, according to the Housing Expediter. The revised estimate therefore allows for only about 400,000 completions out of dwellings started this year.

A year in which 750,000 permanent family dwelling units are completed will be a good building year. But it is disappointing in relation to hopes and needs and still more so because the industry is working to such an extent on last year's business.

Contract Awards

The accompanying chart shows the course of residential contract awards, according to the Dodge Corporation reports covering 37 eastern states. They have held at a high level since the beginning of the year, but have failed to rise seasonally, and lately have run much below a year ago. Moreover, the figures are in dollars, and each dollar provides perhaps one-fourth less construction than a year ago because of higher costs. Awards for other-than-residential construction (manufacturing, commercial, utilities, public works, etc.) have been closer to last year, and have been following last year's seasonal pattern.

The number of contracts for owner-occupied single-family dwellings in April (latest Dodge report) was higher than the month before and April last year, and the increase from March to April was greater than that of last year. Apart-



Construction Contract Awards in 37 Eastern States, Millions of Dollars, Monthly
(Awards during May 1-15, 1947 raised to a full month basis.)

ment family-units provided were down slightly from March but almost double the same month last year. Where the slump has really hit is in single-family dwelling units built for sale or rent, – the "speculative" building. In this group sharp declines occurred in April in comparison with a month and year ago.

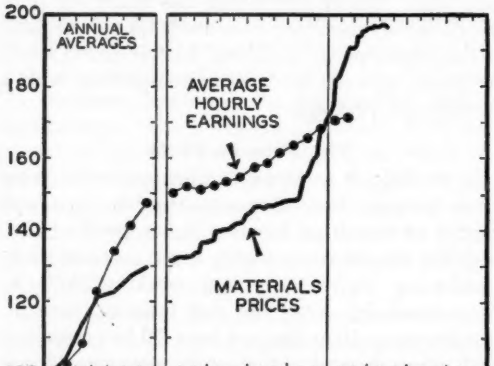
The Rise in Costs

It is difficult to measure changes in building costs because they vary according to type and design of structure, location, labor productivity, and the complexities which beset contractors in combining many parts and working skills to form a whole. Available cost indexes show increases since 1939 ranging from 50 to more than 100 per cent, and actual costs may run 20 per cent or more above computed indexes based on materials and wages, because of inefficiencies, shortages, etc. Costs also can mount because of factors outside the control of the industry, such as the strike in cement plants which recently caused costly interruptions to construction in progress.

Except in foods and farm products few prices have risen as much as the price of housing. This is the fundamental reason why housing is being "priced out of the market." The psychological resistance to paying extreme price advances for houses which too often are of dubious or poor quality is also no small influence.

Reductions in housing costs depend primarily on lower materials and labor costs. There are of course other items which can stand adjustment. Some builders take advantage of the situation by cutting corners in workmanship and materials, or by padding prices for all the traffic will bear. Some building codes require unnecessarily expensive types of construction. But, broadly, materials and labor each account for some two-fifths of total costs.

The accompanying chart shows the rises in wholesale prices of building materials and in average hourly earnings of building workers since 1939, as calculated from U. S. Bureau of Labor Statistics data. The rise in materials prices has been 97 per cent. By the Spring of last year, when construction awards were by far the largest in history and represented considerably more work than the industry could handle, materials prices, according to published indexes, had risen about 40 per cent. When price controls were removed last Fall they rose steeply. Lately the trend has been sideways, as supplies come up to demand. Larger supplies point the way not only to lower prices, but also to reducing excessive construction time and costs resulting from scarcity-caused delays in getting materials. They make better planning possible.



Building Worker Average Hourly Earnings, and Building Materials Wholesale Prices, 1939=100.

The rise in average hourly earnings of building workers since 1939, as shown by the chart, was 71 per cent up to February this year (latest report). A further rise undoubtedly has occurred since. Skilled craft straight-time hourly wage rates run to $2.00 an hour or thereabouts in many urban areas, in some to $2.50 or even higher. For unskilled labor straight-time hourly rates run to a maximum of $1.55 in Newark, N. J. In Detroit, 17,000 building workers walked off their jobs May 1, led by some 9,000 carpenters who asked an increase of 42½¢ hourly over their rate of $1.82½. Brooklyn and Queens County plumbers recently won, through a strike, an increase from $2.25 hourly for a 7-hour day to $2.81¼ for an 8-hour day; and Long Island plasterers have been seeking $3.00.

Greater Efficiency Needed

With building trade wages at record levels all over the country, building workers not only have failed to expand output through increasing productivity, but there is general agreement that they turn out less work than before the war. Surveys covering 12 cities in the Spring of this year, and 18 cities a year ago, conducted by the Engineering News Record, show that the median productivity of skilled building labor this Spring was only 66 per cent of 1939, against last Spring's 65 per cent. In heavy engineering construction, skilled labor productivity improved to better than 80 per cent of 1939, and common labor to 75 per cent, both from 64 per cent a year ago. The figures are shockingly low. In conjunction with the wage increases quoted, they fix the major responsibility for excessive costs.

For decades the building trades unions have enforced regulations which limit workers' productivity. In the main these restrictions originated in labor's desire for protection from construction's highly seasonal pattern, wide cyclical swings and intermittent demand for workers. Nevertheless, abuses throttle progress.

The study, "American Housing – Problems and Prospects" (Twentieth Century Fund, New York), notes that building industry rules and regulations are a curious blend of measures to maintain the quality of work, to protect the health and safety of workmen, to keep wages high and to maintain the union's bargaining power. Some restrict union membership. Others endeavor to spread work by prescribing limits to a "fair day's work". Piecework bonuses for above-average production are outlawed, and even the sizes of capacity-setting tools are prescribed. Use of power tools and other labor-saving devices is curbed. Paint brush widths are limited and use of spray guns restricted. Pre-assembled parts and equipment in some cases are taken apart and reassembled by local labor. The number of men to be used on specified jobs is designated. Skilled artisans are required for tasks which could be performed by unskilled labor.

Work stoppages over jurisdictional disputes add to costs. As an example, a recent series of disputes between carpenters and building laborers in Northern New Jersey, as to which was entitled to handle lumber from truck to job, spread until it held up work on an estimated $40 million of housing.

The Construction Labor Force

The construction labor force is placed at about 2,200,000 at present, with 1,500,000 to 1,700,000 unionized. This number is generally regarded as insufficient to handle the volume of construction believed to be needed for some years ahead. The

number of qualified workers has been held down since the depression of the 1930s, when apprentice training programs collapsed. Although training was revived to some extent in the late 1930s it was interrupted again when war took men into the armed forces. Thus, for about fifteen years there has been inadequate training of building craftsmen.

Progress is being made in training; about 100,000 apprentices now are enrolled in formal programs and the goal is 200,000. The improvement affords no immediate relief, however, because three to four years are required to turn an apprentice into a full-fledged craftsman. As it now stands this training program only approximately makes good the attrition through retirements, withdrawals, or deaths in the present force, and even when a goal of 200,000 in training is achieved the margin of additions to the full force still will be narrow. Development of unemployment in building this year may adversely affect the apprentice program for a time, but is likely to stimulate workers to greater productivity.

Most seasoned workers are of an age where their physical capabilities — an important element in efficiency — hardly compare with those of younger men. In addition, the shortages make workmen feel that their services are indispensable. This has its repercussions not only on wage demands but on work attitudes. Many a bricklayer (for example) who formerly laid around 1,000 bricks a day now lays nearer half that amount. Whether the decline is influenced most by spread-the-work practices, or by desire for leisurely work, or by age handicapping output, is hard to tell. Meanwhile, young, green hands in a crew mean lower average efficiency until the new men develop skills and apply their greater physical abilities.

The Outlook

Building materials prices now seem to have reached a peak, and improved supplies help lower costs. Thus normal influences tending to bring housing prices down are at work. There is a call in building as in everything else for the superior producer, who by better planning, management and methods keeps costs and prices down to the ability of buyers to pay. There are many such, operating successfully even now. Labor has major responsibilities — to step up worker efficiency, to avoid jurisdictional strikes and claims with their costly consequences, to relax craft restrictions which are obviously selfish and harmful.

As the Dodge Corporation recently stated, buyers have assumed control of the construction market. The lesson of the current figures is that unless excessive housing costs are lowered by the cooperation and harder work of all concerned, they will be lowered by the route — less agreeable both for the building trades and for the country as a whole — of unemployment and depression. The "full employment" which everyone wants to promote now is seen in the building trades. It is also seen that full employment is threatened by low productivity and the pyramiding of costs. The concern of the country is to know whether better conditions are to be established by the unions and the housing industry themselves, or compelled by building depression.

Perhaps the answer will be some of both. Wage rates are not likely to be reduced, but other elements of cost are less inflexible. Buyers' resistance and increases in supply both operate to lower materials prices, and the possibilities of raising efficiency on the job, as the flow of materials improves, are great. Although unions resist concessions, individual members may put forth greater effort. The need for housing is unquestionably enormous. Cost declines will uncover new demand. Buyers on their part are wrong to expect that by waiting they may soon be able to buy houses at prewar costs again. Wages and salaries are also costs, and people cannot enjoy postwar wage rates and incomes and at the same time expect to buy at prewar levels.

THE NATIONAL CITY BANK OF NEW YORK

Printed in U. S. A.

ity Bank
York
Wall St.
2

r

U. S. A.